

GAO

United States General Accounting Office

Report to the Chairman, National
Security Committee, House of
Representatives

July 1996

DEFENSE DEPOT MAINTENANCE

Commission on Roles
and Mission's
Privatization
Assumptions Are
Questionable



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National Security and
International Affairs Division

B-271919

July 15, 1996

The Honorable Floyd Spence
Chairman, National Security Committee
House of Representatives

Dear Mr. Chairman:

As you requested, we analyzed the assumptions the Commission on Roles and Missions (CORM) used to support its recommendations for a time-phased plan to privatize essentially all Department of Defense (DOD) depot maintenance activities. Specifically, we examined the assumption that such privatization would save 20 percent and not adversely affect readiness and sustainability. We also addressed the Commission's assumption that requirements for public-private depot maintenance competitions would be limited. Preliminary observations on these issues were also discussed in recent testimony.¹ Other questions contained in your October 12, 1995, request will be answered in later reports.

Results in Brief

The CORM's depot privatization savings and readiness assumptions are based on conditions that do not currently exist for many depot workloads. Privatizing essentially all depot maintenance under current conditions would not likely achieve expected savings and, according to the military services, would result in unacceptable readiness and sustainability risks. The extent to which DOD's long-term privatization plans and market forces will effectively create more favorable conditions for outsourcing is uncertain.

The CORM assumed a highly competitive and capable private market exists or would develop for most depot workloads. However, we found that most of the depot workloads contracted to the private sector are awarded noncompetitively—mostly to the original equipment manufacturer. Additionally, a number of factors would likely limit private sector competition for many workloads currently in the public depots. Without highly competitive and capable private sector markets, the cost and readiness risks of privatizing depot maintenance workloads may prove unacceptable. Further, the CORM's privatization savings do not reflect the cost impact of excess capacity in the public depots. As we have previously reported, privatization without reducing excess capacity will further

¹Defense Depot Maintenance: Privatization and the Debate Over the Public-Private Mix (GAO/T-NSIAD-96-146, Apr. 16, 1996) and (GAO/T-NSIAD-96-148, Apr. 17, 1996).

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exacerbate the severe excess capacity problem in the DOD depot system and increase the cost of workloads, which continue to be maintained in these depots.

The CORM data does not support its depot privatization savings assumption. The CORM's assumption is based primarily on reported savings from public-private competitions for commercial activities under Office of Management and Budget (OMB) Circular A-76. These commercial activities were generally dissimilar to depot maintenance activities because they involved relatively simple, routine, and repetitive tasks that did not generally require large capital investment or highly skilled and trained personnel. Public activities were allowed to compete for these workloads and won about half of the competitions. Many private sector firms generally made offers for this work due to the highly competitive nature of the private sector market for these activities and estimated savings were generally greater in situations where there were larger numbers of private sector offerors. GAO and defense audit reports have stated that projected savings were often not achieved due to cost growth and other factors. Savings did occur from many of these competitions, even though they were less than projected. Nonetheless, the savings resulted from competition rather than from privatization. In the absence of a highly competitive market, privatizing unique, highly diverse and complex depot maintenance workloads that require large capital investments, extensive technical data, and highly skilled and trained personnel will not likely achieve expected savings and could increase the cost of depot maintenance operations.

Our analysis of depot maintenance workloads currently contracted to the private sector found, for the most part, that the contractors were responsive to contract requirements for delivery and performance. However, DOD officials noted that DOD depots provide greater flexibility than contractors and can more quickly respond to nonprogrammed, quick-turnaround requirements. The military services periodically assess the readiness and sustainability risks of privatizing depot workloads. If the risks are determined to be too high, the workloads are retained in the public depots. Historically, the services have determined that the risks of privatizing most workloads are too high and have retained them in the public depots. These assessments have provided the primary justification for maintaining a large organic depot maintenance core capability. The CORM report stated that the services' organic depot maintenance requirements exceed the real needs of the national military strategy and that private contractors could provide essentially all of the depot

maintenance services now conducted in government facilities within the United States. We found that DOD's risk assessment methodology does not include guidance or criteria for the services to use in making such assessments and involves subjective judgments. Consistent with DOD's recently announced policy preference for privatizing depot maintenance workloads, the services are currently reassessing their previously designated core workloads with a view toward privatization.

The CORM assumed that public-private competitions would only be used in the absence of private sector competition and would be limited to only a few cases. We found that public-private depot maintenance competitions have resulted in savings and benefits and can provide a cost-effective way of making depot workload allocation decisions for certain workloads. The beneficial use of such competitions could have significantly more applicability than the Commission assumed.

Background

DOD annually spends about \$15 billion for depot maintenance work that includes repairing, overhauling, modifying, and upgrading aircraft, ships, tracked and wheeled vehicles, and other systems and equipment. It also includes limited manufacture of parts, technical support, modifications, testing, and reclamation as well as software maintenance. DOD estimates that about 60 percent of its expenditures for depot maintenance work is performed in its 24 maintenance depots and the remaining 40 percent in the private sector. We have reported that the public-private mix is closer to 50-50 when it includes interim contractor support services and public depot purchases of parts, supplies, and maintenance services from the private sector.

Historically public depots have served to provide a ready and controlled source of repair and maintenance. Reductions in military force structure and related weapon system procurement, changes in military operational requirements due to the end of the Cold War, and increased reliability, maintainability, and durability of military systems have decreased the need for depot-level maintenance support. Efforts to downsize and reshape DOD's maintenance system have addressed depot efficiency and the workload mix between the public and private sectors. A key issue currently being debated within Congress and DOD is the extent to which the private sector should be relied on for meeting DOD's requirements for depot-level maintenance.

Congress, in the National Defense Authorization Act for Fiscal Year 1994, established the Commission on Roles and Missions of the Armed Forces to (1) review the appropriateness of the current allocations of roles, missions, and functions among the armed forces; (2) evaluate and report on alternate allocations; and (3) make recommendations for changes in the current definition and distribution of those roles, missions, and functions. The Commission's May 24, 1995, report, Directions for Defense, identified a number of commercial activities performed by DOD that could be performed by the private sector. Depot-level maintenance was one of these activities. The Commission concluded that privatizing such commercial activities through meaningful competition was the primary path to more efficient support. It noted that such competition typically lowers costs by 20 percent.

Based on its conclusions, the Commission recommended that DOD transition to a depot maintenance system relying on the private sector by, (1) directing support of all new systems to private contractors, (2) establishing a time-phased plan to privatize essentially all existing depot-level maintenance, and (3) creating an office under the Assistant Secretary of Defense (Economic Security) to oversee privatization of depots. In his August 24, 1995, letter to Congress forwarding the Commission report, the Secretary of Defense agreed with the Commission's recommendations but expressed a need for DOD to retain a limited organic core capability to meet essential wartime surge demands, promote competition, and sustain institutional expertise. DOD's January 1996 report, Plan for Increasing Depot Maintenance Privatization and Outsourcing, provides for substantially increasing reliance on the private sector for depot maintenance.

Data Does Not Support the CORM Depot Privatization Savings Assumption

The CORM, in support of its depot privatization savings assumption, cites reported savings from public-private competitions under OMB Circular A-76.² These competitions were for various non-depot maintenance commercial activities, in which there was generally a highly competitive private market. Projected savings were greater for competitions having larger numbers of private sector competitors. The public sector won about half of these competitions. Our analysis indicates that private sector competition for depot maintenance may be much less than found in the A-76 activities. The data also suggests that little or no savings would result from privatizing depot maintenance in the absence of competition.

²OMB Circular A-76 provides policy guidance and instructions for federal agencies to use in identifying and determining whether certain government activities should be outsourced to the private sector.

The CORM report cites two studies supporting its savings assumption—one by OMB and one by the Center for Naval Analysis (CNA).³ Both reports are evaluations of numerous public-private competitions for commercial activities under OMB Circular A-76 guidelines. The commercial activities included base operating support functions such as family housing, real property maintenance, civilian personnel administration, food service, security, and other support services. These activities are characterized by highly competitive markets with low-skill labor, little capital investment, and simple, routine and repetitive tasks that can readily be identified in a contract statement-of-work. None of the competitions studied were for depot maintenance, which generally has dissimilar characteristics. Both reports show that substantial savings occurred when competition was introduced into the noncompetitive environment. However, the reported savings are based on the difference between the precompetition cost and the price proposed and do not reflect subsequent contract cost overruns, modifications, or add-ons. Based on a limited number of audits, projected A-76 privatization savings were often reduced or eliminated as a result of subsequent contract cost growth.

The OMB study of commercial activities competed from 1981 to 1988 cited average savings of 30 percent from original government cost with an average 20-percent savings when the government won the competition and 35 percent when the private sector won.⁴ About 40 percent of competitions were won by government, 60 percent by the private sector.

The CNA study cites a previous CNA review of the Navy's Commercial Activities Program in which both the public and private sectors each won about half the roughly 1,000 competitions reviewed.⁵ The offers where the public sector won were roughly 20 percent lower than the precompetition cost baseline, whereas winning offers from private firms averaged 40 percent below earlier costs. The report noted that larger private sector savings occurred when activities were performed predominately by military personnel. Nearly all depot maintenance work is performed by DOD civilians. In 29 percent of the cost studies reviewed, there were no cost savings.

³A 1988 OMB study titled Enhancing Government Productivity Through Competition: A New Way of Doing Business Within the Government to Provide Quality Government at Least Cost and a 1994 CNA study entitled Issues Concerning Public and Private Provision of Depot Maintenance.

⁴Enhancing Governmental Productivity Through Competition: A New Way of Doing Business Within the Government to Provide Quality Government at Least Cost (OMB, Aug. 1988).

⁵Analysis of the Navy's Commercial Activities Program, Center for Naval Analysis, July 1993.

These studies did not specifically address outsourcing to the private sector when the public sector did not participate in the competition. Since the government's costs were lower in about half the cases, these savings would not have been realized without public competition. Further, in limited situations where audits have been conducted, projected savings have not been verified. For example, a 1989 Army Audit Agency report summarizing the results of prior commercial activities reviews stated that for 10 functions converted to contractor performance, only \$9.9 million of \$22 million in projected savings were realized.⁶ Performance work statement deficiencies, mandatory wage rate increases received by contractor personnel, and higher-than-estimated contract administration costs accounted for about 90 percent of the reduction in estimated savings.

Our 1990 report on OMB Circular A-76 savings projections found (1) costs of conducting the competitions were not considered in estimating savings, (2) savings figures were projections and were not based on actual experience, (3) DOD lacked information regarding modifications made after the cost study, (4) DOD's A-76 database contained inaccuracies and incomplete savings data, and (5) an error in design resulted in a computer program that miscalculated program savings.⁷

A July 1995 Congressional Budget Office report entitled Public and Private Roles in Maintaining Military Equipment at the Depot Level stated that contracting out was most likely to outperform public depots if competition existed among private firms. The report noted, however, that without competition, the private sector's ability to provide service for the least cost could be reduced and the risk of poor-quality or nonresponsive support could increase. The CORM report also states that savings occur when meaningful competition is obtained in a previously sole-source area and public-private competitions are preferable to noncompetitive awards to the private sector.

Conditions Limiting Depot Maintenance Privatization

The CORM recognized that privatizing essentially all depot maintenance would require a time phased approach. Under current conditions, privatizing essentially all depot workloads (1) would not likely achieve expected savings and could prove more costly, (2) could adversely impact

⁶Report of Audit: Contractor Operations of Commercial Activities, U.S. Army Audit Agency, EC 89-205, June 9, 1989.

⁷OMB Circular A-76: DOD's Reported Savings Figures Are Incomplete and Inaccurate (GAO/GGD-90-58, Mar. 15, 1990).

readiness, and (3) would be difficult if not impossible under existing laws. These conditions are discussed below.

Achieving Expected Privatization Savings Not Likely Under Current Conditions

Limited competition and excess depot capacity could negate expected savings. The CORM assumed depot workload privatization savings would result from private sector competition. We found that much of the depot work contracted to the private sector is awarded noncompetitively and that obtaining competition for remaining non-core depot workloads may be difficult and costly. In addition, privatizing depot workloads without reducing excess depot capacity could significantly increase the cost of work performed by the depots.

Limited or No Competition for Most Contracted Depot Workloads

The CORM's recommendation to privatize essentially all depot maintenance assumed that meaningful competition would be obtained for most of the work. The Commission generally defined meaningful competition as that generated by a competitive market, including significant numbers of both buyers and sellers. Our review of selected DOD depot maintenance contracts found that a large portion of the awards were not made under these conditions. To determine the extent of competition in awarding depot maintenance contracts, we reviewed 240 such contracts totaling \$4.3 billion at 12 DOD buying activities. We selected high-dollar value contracts from a total of 8,452 open 1995 depot-level maintenance contracts that were valued at \$7.3 billion. As shown in table 1, 182 of the 240 contracts—76 percent—were awarded on a sole-source basis. These contracts accounted for 45 percent of the total dollar value. In nine other contracts accounting for about 4 percent of the total, competition was limited to only two offerors. The remaining 49 contracts were classified as awarded through full and open competition. These awards accounted for 51 percent of the total dollar value. However, some had only limited responses. For example, the number of offerors was 2 in each of 5 contracts totaling \$525.8 million—24 percent of the total award value for the 49 competed contracts.

Table 1: Procedures for Contract Award^a

Dollars in billions

| Command | Competition | | | | Sole source | | Total awards | |
|--------------|---------------|----------------|----------|----------------|-------------|----------------|--------------|----------------|
| | Full and open | | Limited | | | | | |
| | Number | Value | Number | Value | Number | Value | Number | Value |
| Army | 10 | \$0.578 | 3 | \$0.017 | 43 | \$0.538 | 56 | \$1.133 |
| Air Force | 37 | 1.348 | 1 | 0.100 | 60 | 0.900 | 98 | 2.348 |
| Navy | 2 | 0.286 | 5 | 0.048 | 79 | 0.518 | 86 | 0.852 |
| Total | 49 | \$2.212 | 9 | \$0.165 | 182 | \$1.956 | 240 | \$4.333 |

^aThe classification of full and open, limited, and sole source were assigned by DOD buying activities. Limited means competitions conducted using other than full and open competition.

Original equipment manufacturers were awarded 158 of the 182 noncompetitive contracts. The remaining 24 were awarded on a sole-source basis for reasons such as peculiar requirements, national emergencies, and international agreements. Where competition was limited, the OEMs won eight of the nine workloads. The OEMs also won 9 of the 49 contracts that DOD classified as awarded pursuant to full and open competition. Table 2 shows the number of offers received for the contracts classified as awarded pursuant to full and open competition.

Table 2: Offerors for Competed Contracts

Dollars in millions

| | Number of contracts | Award value | Number of offerors | Percent of total value |
|--------------|---------------------|------------------|--------------------|------------------------|
| | 5 | \$525.8 | 2 | 24 |
| | 11 | 514.5 | 3 | 23 |
| | 14 | 861.8 | 4 | 39 |
| | 3 | 75.3 | 5 | 03 |
| | 16 | 234.1 | 6-10 | 11 |
| Total | 49 | \$2,211.5 | | |

The buying activities awarded the maintenance contracts to 71 different contractors but 13 of these contractors had received workloads valued at \$3.3 billion—76 percent of the total amount awarded. Table 3 shows the distribution of the workload to the 71 contractors.

Table 3: Contract Value Distribution of Work Awarded

Dollars in millions

| Contract value | Number of contractors | Total award value |
|----------------|-----------------------|-------------------|
| \$ < 1 | 5 | \$4.1 |
| 1 - 10 | 26 | 112.7 |
| 11 - 30 | 14 | 239.2 |
| 31 - 60 | 9 | 405.2 |
| 61 - 100 | 4 | 299.0 |
| 100 > | 13 | 3,272.6 |
| Total | 71 | \$4,332.8 |

Difficulty and Cost of Competing Non-Core Workloads

Although DOD plans to privatize non-core workloads currently in the public depots, it has not assessed the extent that such workloads will attract private sector competition. Factors that resulted in noncompetitive awards for much of the depot work currently performed by the private sector, may apply to much of the work currently performed by public depots. The types of existing public workloads where private sector competition may be limited include: (1) workloads where data rights necessary for competition have not been acquired, (2) small workloads that do not justify large private sector capital investment costs, (3) workloads for older and/or highly specialized systems, (4) workloads with erratic requirements where DOD cannot guarantee a stable workload, and (5) workloads that would be costly to move from one source of repair to another. These factors could further limit cost-effective privatization of existing workloads. For example, our review of 95 non-ship depot maintenance public-private competitions found that 22 did not receive any private sector offers and 33 only had 1.

DOD may have to acquire the technical data rights to compete many of its weapon systems. The most-often-cited justification for the 182 sole-source awards was that competition was not possible because DOD did not own the technical data rights for the items to be repaired. Command officials stated that DOD will have to make costly investments in order to promote full and open competition for many of its weapon systems. For example, in its justification for less than full and open competition for the repair and testing of the AN/URQ-33 Joint Tactical Information Distribution System, the Warner Robins Air Logistics Center noted that the technical data was not procured from the original equipment manufacturer and estimated that \$1 million and a minimum of 6 months would be required to start up a new contractor. Similarly, the Army Missile Command's justification for a

sole-source maintenance and repair award to the original equipment manufacturer for the AH-58D Kiowa Warrior helicopter, noted that the program manager had not procured the technical data package due to funding and cost restraints. The command estimated that technical data suitable for full and open competition would cost about \$18 million.

The difficulty of accurately describing or quantifying depot maintenance requirements may impact privatization savings. Under fixed-price contracts, more of the risks are incurred by the contractor. If costs are greater than expected, then the contractor incurs the loss. The government incurs more risk under a cost reimbursable contract. Under such contracts, the government generally reimburses the contractor for the costs incurred. Accordingly, the contractor's incentive to maximize efficiency and minimize cost is generally greater under a fixed-price contract. Cost reimbursable contracts are often used when contract requirements cannot be adequately described and/or costs accurately estimated. Such contracts are used for many depot maintenance workloads.

Our analysis of the 240 contracts showed that the commands used fixed-price contracts in 151 (or 63 percent) of the 240 contracts, cost-reimbursable type contracts in 61 contracts, and a combination of the 2 types in 28 contracts. Table 4 shows the types of contracts the commands were using to acquire depot-level maintenance.

Table 4: Types of Contracts

| | Firm fixed price | Cost reimbursement | Combination | Total |
|--------------|-----------------------------|-------------------------------|--------------------|--------------|
| Army | 19 | 30 | 7 | 56 |
| Air Force | 63 | 26 | 9 | 98 |
| Navy | 69 | 5 | 12 | 86 |
| Total | 151 | 61 | 28 | 240 |

The buying activities said they used fixed pricing in the 151 contracts because adequate repair histories were available to establish a price range for the maintenance work. In using 61 cost-reimbursement type contracts, DOD officials stated that the maintenance requirements could not be predetermined for the contract period or that no adequate repair history existed to establish reasonable price ranges.

Privatization Could Reduce Public Depot Efficiency and Increase Costs

Non-core workloads that may be good candidates for privatization—that is, a competitive private market exists—may not be cost-effective to privatize if it results in increased excess capacity and other inefficiencies in the public depots.

Given the requirement to preserve public depot capabilities, DOD must manage depot maintenance workloads to assure efficient operations. In some cases where privatizing a particular workload could produce some level of savings, the savings could be more than offset by creating inefficiencies in the remaining public depots. For example, the Air Force's Oklahoma City Air Logistics Center currently has about 43 percent excess capacity. Had DOD decided to reallocate the engine workload from the closing San Antonio Center to Oklahoma City instead of privatizing the workload in place, the labor hour rate for all of the Oklahoma City Center's work would be reduced by \$10 an hour. Such a reduction could save about \$70 million a year.

Large-Scale Privatization Could Affect Readiness

Our analysis of depot maintenance work currently contracted with the private sector found that contractors, for the most part, were responsive to DOD's needs in terms of meeting contractual requirements for delivery and performance. However, service officials stated that historically, the flexibility and responsiveness of DOD depots had significantly influenced decisions to select a DOD depot rather than a contractor for most critical military systems. The military services have considered the readiness and sustainability risks of privatizing existing depot workloads and determined that the risks for privatizing most workloads were too high. In the past, these assessments provide the primary justification for maintaining a large organic depot maintenance core capability.

DOD is implementing a new depot maintenance policy that is likely to significantly increase the depot maintenance workloads performed by the private sector. Based on the policy preference for contractor maintenance, DOD is now conducting risk assessments on workloads previously designated as core. In many cases, the services are redesignating mission essential core workloads as non-core. DOD's March 1996 depot workload report to Congress, which reflects its latest "core" workload determinations, projects that the fiscal year 1997 depot workload mix of about 60 percent public and 40 percent private will shift to about a 50/50 mix by fiscal year 2001. However, these projections were not developed using the DOD's new risk assessment process. We recently reported that

DOD's ongoing risk assessment process will likely result in an even greater shift of depot maintenance workload to the private sector.⁸

As required by the fiscal year 1996 Defense Authorization Act, we analyzed and reported on DOD's March 1996 depot workload report.⁹ We noted that the DOD's risk assessment process is based to a large extent on subjective judgements. Further, DOD's methodology for assessing workload privatization risks does not include guidance or criteria for the services to use in making such assessments. As a result, the services individual risk assessments may not be consistent within the services or uniform among the services. The CORM report stated that DOD core depot requirements exceed the real needs of the national security strategy and that with proper oversight private contractors could provide essentially all of the depot-level maintenance services now conducted in government facilities.

To evaluate contractor support and responsiveness for the workloads currently in the private sector, we analyzed contract modifications to 195 of the 240 contacts reviewed. We only found indications of contractor performance problems in four of these contracts. These involved extensions to the period of performance due to the contractors not meeting the required delivery dates. However, DOD materiel managers noted that DOD depots provide greater flexibility than contractors and can more quickly respond to nonprogrammed, quick-turnaround requirements. Further, DOD contracting personnel stated that contract files may or may not provide a reasonable assessment of readiness impacts. For example, these files would provide no indication of the impacts of cost growth on DOD's ability to procure required depot maintenance services.

Legal Limitations to Depot Privatization

In recommending that essentially all depot maintenance work be privatized, the Commission recognized that privatization could be limited or precluded by a collection of laws, regulations, and historic practices developed to protect the government's depot maintenance capability. Among the barriers cited were 10 U.S.C. 2469, which requires public-private competitions before any workload over \$3 million can be moved to the private sector from a public depot, and 10 U.S.C. 2466, which sets the amount of depot-level maintenance workload that must be performed in public depots to not less than 60 percent, that is, the 60/40

⁸Defense Depot Maintenance: DOD's Policy Report Leaves Future Role of Depot System Uncertain (GAO/NSIAD-96-165, May 21, 1996).

⁹Defense Depot Maintenance: Public-Private Workload Data Is of Questionable Value to Decisionmakers (GAO/NSIAD-96-66, May 18, 1996).

rule. Since the concept of core¹⁰ requirements centers around the determination of acceptable levels of risks, the size and extent of core capability and requirements can become somewhat subjective. Accordingly, the amount of depot work subject to privatization may be driven in part by the 60/40 rule.

DOD is seeking repeal of these and other laws in order to fully implement its depot privatization plans. For example, in May 1996, DOD proposed a provision that would allow the Secretary of Defense to acquire by contract from the private sector or any nonfederal government entities those commercial or industrial type supplies and services necessary or beneficial to the accomplishment of DOD's authorized functions, notwithstanding any provision of title 10 or any statute authorizing appropriation for or making DOD appropriations. This proposal was not supported by the DOD authorization committees during deliberations over the fiscal year 1997 DOD authorization bill.

Despite Limitations, Public-Private Competitions Produced Savings and Benefits

The CORM recognized that there are instances where establishing competition within the private sector would be too costly. In these cases, the Commission stated that public-private competition, however imperfect, was generally preferable to noncompetitive contracts. The CORM assumed, however, that there were only a few cases in which such competitions would be required. We found that requirements for and benefits of such competitions may be greater than assumed. As noted earlier in this report, most depot workloads currently contracted to the private sector are noncompetitive and obtaining private sector competition for those workloads currently in the public depots could prove difficult and costly. In examining DOD's experience with public-private competition for depot-level maintenance, we found that the competitions generally resulted in savings, but precisely quantifying the savings is difficult because many other variables affect maintenance costs. We also found that some workloads are not well suited for competing—either private-private or public-private.

DOD's experience with public-private competition for depot-level maintenance began in 1985 when Congress¹¹ authorized the Navy to compete shipyard workloads. In 1991, with DOD's push to promote

¹⁰DOD defines core as the capability maintained within the organic defense depots to meet readiness and sustainability requirements of the weapon systems that support the Joint Chiefs of Staff contingency scenarios.

¹¹The 1985 Department of Defense Appropriations Act, Public Law 98-473.

efficiency in depot maintenance operations and the Navy's assertion that competition encouraged public shipyards to become more efficient, Congress¹² permitted the Air Force and the Army to conduct public-private competitions for depot-level maintenance workloads. DOD had planned to use the program for allocating maintenance workloads to the most cost-efficient providers and to save \$1.7 billion as part of its strategy to achieve an overall \$6.3 billion reduction in depot maintenance costs from fiscal years 1991 to 1997.¹³ However, DOD suspended the program in May 1994 and reported to Congress in February 1995 that competition could not be reinstituted until its cost accounting and data systems permitted actual cost accounting for specific workloads.

During our review of the Navy's public-private competition program for aviation maintenance,¹⁴ Navy officials stated that such competitions had been beneficial to the government and resulted in maintenance savings for the involved workloads. They stated that competitions for workloads that had previously been assigned to Navy depots resulted in the Navy depots streamlining overhead, improving work processes, reducing labor and material requirements, and instituting other cost-saving initiatives in order to submit the lowest bids and avoid job losses. For example, the public-private competition for F-14 aircraft airframe overhauls—a competition won by a Navy depot—resulted in the depot reducing the average cost per overhaul from \$1.69 million the year preceding the competition to \$1.29 million, in inflation adjusted dollars, the year following the competition, a 24-percent decrease.

A number of factors have limited DOD public-private competitions. They include: (1) private sector concerns regarding the fairness of competitions; (2) the time and cost of contract solicitation, award, and administration; (3) declining depot requirements and the inability to guarantee stable workloads; (4) lack of government-owned technical data packages; and (5) limited sources of repair, and low-dollar value workloads that generate little or no interest from the private sector. An April 1994 DOD task force report on depot-level activities identified several concerns with continuing public-private competitions. For example, efficiencies achieved would not be as likely in the future because the costs of conducting competitions were high and the payoffs would be progressively smaller as workloads were recompeted.

¹²National Defense Authorization Act for Fiscal Year 1991, Public Law 101-510.

¹³These cost reductions were mandated by Defense Management Review Decision 908C, "Consolidating Depot Maintenance" dated January 12, 1991.

¹⁴Navy Maintenance: Assessment of the Public-Private Competition Program for Aviation Maintenance (GAO/NSIAD-96-30, Jan. 22, 1996).

Critics of public-private competitions charge that such competitions are inherently unfair because DOD's accounting and financial management systems do not capture and reflect all the costs. In February 1995, DOD reported to the House and Senate Appropriations Committees that its automated financial management systems and databases did not provide an accurate basis for determining the actual cost of specific competition workloads. To remedy this situation, DOD was developing policies, procedures, and automated processes that would permit actual cost accounting for specific workloads accomplished in public depots.

Our January 1996 report to the Ranking Minority Member, Subcommittee on Defense, Senate Committee on Appropriations, summarized many actions DOD had taken to improve public-private competitions.¹⁵ Among these actions were (1) the development of a cost comparability handbook that, among other things, identified adjustments that should be made to public depots' offers as a result of differences in the military services' accounting systems and (2) having the Defense Contract Audit Agency certify that successful offers included comparable estimates of all direct and indirect costs. We noted that the incentive to continue with some of the initiatives was lost after DOD terminated public-private competitions. We also identified additional actions that DOD could take to further improve competitions, for example, provide the Defense Contract Audit Agency the technical support needed to properly evaluate depot offers and to conduct an incurred cost audit to assess whether depots are able to perform work as offered.

Our report also summarized the Navy's suggestions for addressing concerns regarding public depot cost overruns and administration costs resulting from competitions. These included establish fixed prices for the competed work based on offer amounts, execute the work like normal workload using existing control systems with no separate contract administration, and assess penalties for cost overruns to make the depot less competitive in future competitions.

Agency Comments

DOD officials declined to comment on this report. They noted that the draft report we provided for comment included no recommendations and did not require a response. Further, the report addresses assumptions of the Commission on Roles and Missions of the Armed Forces, a group established by Congress that no longer exists. While the Commission on

¹⁵Navy Maintenance: Assessment of the Public-Private Competition Program for Aviation Maintenance (GAO/NSIAD-96-30, Jan. 1996).


Roles and Missions was not a DOD entity, in forwarding the Commission's report to Congress, the Secretary of Defense stated that DOD agreed with the Commission's recommendation to outsource a significant portion of DOD's depot maintenance work. Further, DOD's January 1996 report on outsourcing depot maintenance cited the Commission's savings projections as its rationale for its depot privatization initiative.

Appendix I sets forth our scope and methodology. We will continue evaluating DOD's actions on its plans to privatize depot-level maintenance to complete our response to issues raised by the National Security Committee.

We are sending copies of this report to the Secretaries of Defense, the Army, the Navy, and the Air Force; the Director of the Office of Management and Budget; and interested congressional committees. Copies will be made available to others upon request.

If you or your staff have any questions concerning this report, please contact me on (202) 512-8412. Major contributors to this report are listed in appendix II.

Sincerely yours,

A handwritten signature in black ink, reading "David R. Warren". The signature is fluid and cursive, with a long horizontal stroke at the end.

David R. Warren, Director
Defense Management Issues

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Abbreviations

| | |
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| ATCOM | Aviation and Troop Support Command |
| CECOM | Communications-Electronics Command |
| CORM | Commission on Roles and Missions |
| CNA | Center for Naval Analysis |
| DOD | Department of Defense |
| MICOM | Missile Command |
| NICP | Naval Inventory Control Point |
| NAVAIR | Naval Air Systems Command |
| OC-ALC | Oklahoma City Air Logistics Center |
| OO-ALC | Odgen Air Logistics Center |
| OMB | Office of Management and Budget |
| SA-ALC | San Antonio Air Logistics Center |
| SM-ALC | Sacramento Air Logistics Center |
| TACOM | Tank-Automotive and Armaments Command |
| WR-ALC | Warner Robins Air Logistics Center |

Objectives, Scope, and Methodology

The Chairman of the House Committee on National Security asked us to comment on the May 1995 report by the Commission on Roles and Missions of the Armed Forces that recommended the Department of Defense (DOD) privatize its depot-level maintenance activities. The Chairman requested that we review a number of issues related to the Commission's report; this report provides information on the Commission's assumptions that privatization could reduce maintenance costs by 20 percent and the potential impact of privatization on military readiness and sustainability. It also identifies some areas DOD may need to improve if it moves toward total privatization of depot-level maintenance.

To evaluate the Commission's assumptions about cost savings from privatization and the impact that it might have on readiness and sustainability, we reviewed its report, discussed the assumptions with former staff members of the Commission, and reviewed supporting data that the Commission had maintained. We made extensive use of our prior work and the work of others on issues related to DOD's depot-level maintenance operations to determine how consistent the Commission's work was with prior findings, conclusions, and recommendations. In addition, we analyzed selected depot-level contracts to evaluate (1) the extent to which DOD used competitive procedures in awarding the contracts and (2) how well the contractor performance responded to DOD's depot-level maintenance needs.

We performed our review at the following:

- Four Army buying activities: the Aviation and Troop Support Command (ATCOM), St. Louis, Missouri; the Communications-Electronics Command (CECOM), Fort Monmouth, New Jersey; the Missile Command (MICOM), Redstone Arsenal, Alabama; and the Tank-Automotive and Armaments Command (TACOM), Warren, Michigan.
- Five Air Force buying activities: Odgen Air Logistics Center (OO-ALC), Hill Air Force Base, Utah; Oklahoma City Air Logistics Center (OC-ALC), Tinker Air Force Base, Oklahoma; Sacramento Air Logistics Center (SM-ALC), McClellan Air Force Base, California; San Antonio Air Logistics Center (SA-ALC), Kelly Air Force Base, Texas; Warner Robins Air Logistics Center (WR-ALC), Robins Air Force Base, Georgia.
- Three Navy buying activities: the Naval Inventory Control Point (NICP), Mechanicsburg, Pennsylvania; Naval Inventory Control Point (NICP), Philadelphia, Pennsylvania; and Naval Air Systems Command (NAVAIR), Arlington, Virginia.

DOD maintains a database on all contract awards that contains data on awards made by competition and awards that are made by other than competition. We did not use this database to evaluate DOD's use of competitive procedures for depot-level maintenance because a test at one Army command showed coding errors and difficulty in identifying maintenance contracts. Therefore, we asked each buying activity to identify all depot-level maintenance contracts that were open at a given point during 1995 for use in evaluating the extent they had used competitive procedures and contractor performance.

Each buying activity provided a list of contracts from their database. We did not attempt to verify the accuracy of the buying activities' databases. The data contained a large number of small contracts. For timeliness, we chose to cover dollar value rather than numbers of contracts. We arranged the dollar value of the contracts from highest to lowest and selected high-dollar value contracts that would provide us at least 50-percent coverage of the total dollar value awarded by each service. Table I.1 presents the universe of contracts identified and our sample size.

Appendix I
Objectives, Scope, and Methodology

Table I.1: Universe and Sample Size

| Dollars in millions | | | | | |
|--------------------------|----------------------------|--|--------------------|-------------------------------|--------------------------------------|
| Buying activities | Number of contracts | Total contract dollar value^a | Sample size | Dollar value of sample | Percent of total dollar value |
| Army | | | | | |
| ATCOM | 825 | \$766 | 20 | \$325 | 0.42 |
| CECOM | 26 | 651 | 13 | 615 | 0.94 |
| MICOM | 143 | 317 | 20 | 185 | 0.58 |
| TACOM | 10 | 10 | 3 | 9 | 0.84 |
| Subtotal | 1,004 | \$1,745 | 56 | \$1,133 | 0.65 |
| Air Force | | | | | |
| OO-ALC | 341 | 2,371 | 20 | 1,665 | 0.70 |
| OC-ALC | 585 | 72 | 20 | 26 | 0.36 |
| SM-ALC | 221 | 119 | 18 | 72 | 0.61 |
| SA-ALC | 586 | 253 | 20 | 87 | 0.35 |
| WR-ALC | 535 | 1,058 | 20 | 498 | 0.47 |
| Subtotal | 2,268 | \$3,872 | 98 | \$2,348 | 0.61 |
| Navy | | | | | |
| NICP-Philadelphia | 176 | 433 | 20 | 217 | 0.50 |
| NAVAIR | 39 | 949 | 6 | 522 | 0.55 |
| NICP-Mechanicsburg | 4,965 | 273 | 60 | 113 | 0.41 |
| Subtotal | 5,180 | \$1,655 | 86 | \$851 | 0.51 |
| Total | 8,452 | \$7,272 | 240 | \$4,333 | 0.60 |

^aTotal may not add due to rounding.

At the buying activities we visited, we reviewed the files of selected contracts to identify cost, schedule, and performance issues. We also discussed the contracting process and contractor performance with contracting officers, negotiators, and specialists. To identify contract types and contracting methods suitable for depot-level maintenance, we reviewed the Federal Acquisition Regulation and DOD supplements and talked to personnel from the Defense Contract Audit Agency and Defense Contract Management Command.

We conducted our review between February 1995 and April 1996 in accordance with generally accepted government auditing standards.

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